

DRAFT

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
ENERGY DIVISION
Item 46 ID# 3336
RESOLUTION G-3363
April 22, 2004

R E S O L U T I O N

Resolution G-3363. Pacific Gas & Electric Company (PG&E), Southern California Gas Company (SoCalGas), and San Diego Gas & Electric Company (SDG&E) file revisions to their tariffs to comply with Decision (D.) 03-10-087 regarding accounting and ratemaking treatment of the El Paso Settlement proceeds. PG&E's, SoCalGas' and SDG&E's filings are approved with modifications.

By PG&E Advice Letter (AL) 2502-G filed on December 3, 2003.
By PG&E AL 2503-G filed on December 3, 2003.
By PG&E AL 2504-G filed on December 3, 2003.
By SoCalGas AL 3318 filed on December 3, 2003.
By SDG&E AL 1541-E/1416-G filed on December 3, 2003.

SUMMARY

This resolution approves, with modifications, the tariffs and refund plans submitted with PG&E's AL 2502-G, AL 2503-G, and AL 2504-G, SoCalGas' AL 3318, and SDG&E's AL 1541-E/1416-G. These advice letters were filed in compliance with D.03-10-087, and establish accounting and ratemaking treatment for the appropriate proportional shares of the El Paso Settlement consideration for certain customer classes. This resolution primarily addresses the amount of the Settlement payments allocated up-front to some core gas (i.e. core aggregation and core subscription) and certain wholesale gas transportation customers. In D.03-10-087, the Commission ordered that these customer classes receive their share of the El Paso refund in the form of an up-front cash refund, based on their share of net present value of future refund streams.

The protest to PG&E's AL 2502-G, filed by the School Project for Utility Rate Reduction (SPURR), is denied. SPURR argued that PG&E's use of PG&E's after-tax authorized rate of return (7.8% for 2003) for the discount rate was inappropriate to calculate the net present value refund amount for its core aggregation customers. (PG&E used the same discount rate in AL 2503-G and

2504-G for its core subscription and wholesale gas transportation customers, respectively.) Instead of PG&E's 7.8% discount rate, SPURR recommended the use of a discount rate between the range of 4.0% to 5.0%. SoCalGas and SDG&E also used their after-tax authorized rate of returns (currently at 8.68% and 8.77%, respectively) for the discount rates used to calculate refund amounts for their core subscription and core aggregation customers.

This resolution determines that an appropriate, consistent discount rate for PG&E's, SoCalGas' and SDG&E's core aggregation, core subscription, and/or wholesale gas transportation customers is 7.86%, using a 20-year payment stream to calculate the net present refund values. The use of these figures is consistent with the El Paso Settlement,¹ and in keeping with the Commission's intent that "the refund plan should calculate the 'up-front' payment based upon a net present value (NPV) of a reasonable forecast of potential payments using a reasonable proposed discount rate."² In addition, this methodology for calculating the net present value will appropriately reflect the level of risk associated with the long-term receipt of payments from El Paso.

BACKGROUND

As a result of numerous investigations, complaints and litigation regarding El Paso's alleged contribution to the extremely high natural gas and electric prices in California during the 15-month period from March 1, 2000 through May 31, 2001, El Paso Natural Gas Company (El Paso) agreed to a Settlement, in which it agreed to provide to all Settlement parties an estimated \$1.5 billion (nominal value)³ in consideration for resolving all related litigation.⁴ An estimated

-
1. Exhibit No. 1 in R.03-07-008.
 2. D.03-10-087, page 24.
 3. However, this amount is subject to change based upon the final amount of proceeds received from sale of El Paso stock and any additional eligible parties ultimately included in the Settlement Agreement.
 4. The Settlement will become effective upon approval of the Federal Energy Regulatory Commission (FERC), the San Diego Superior Court, and the United States Bankruptcy Court.

\$1 billion of the consideration will ultimately benefit the California public utilities and ratepayers under the Commission's jurisdiction. Approximately \$600 million of the estimated \$1 billion will be allocated to gas and electric utilities directly under our jurisdiction. Further, about \$425 million will be payable to the California Department of Water Resources (CDWR), which CDWR has committed to use to reduce amounts which contribute to CDWR's revenue requirement paid by ratepayers under the Commission's jurisdiction.⁵

The Commission established Order Instituting Rulemaking (R.) 03-07-008 to consider proposals for accounting and ratemaking mechanisms to equitably distribute the proceeds from the Settlement to entities under its jurisdiction. The consideration received by PG&E, SoCalGas and SDG&E will include upfront cash (including proceeds from the sale of El Paso stock upon the finalization of the Settlement Agreement) and ongoing fixed semiannual cash payments for 15-20 years (depending on whether El Paso becomes Investment Grade). PG&E's, SoCalGas' and SDG&E's estimated portions of the total gas consideration, to be received over the Settlement period, are approximately \$75 million, \$36 million, and \$29 million, respectively.⁶

In D.03-10-087, the Commission adopted a methodology for distribution of the El Paso refund to the utilities' customer classes. For core aggregation, core subscription and certain wholesale gas transportation customers, the Commission adopted an "up-front" payment approach. Under the Commission's adopted methodology, these customer classes would be allocated the estimated net present value of their share of future refund streams. The first payment under the Master Settlement Agreement (MSA) that would otherwise be recorded to each utility's Purchased Gas Account (PGA) would be recorded net of the limited amounts allocated up-front to these customer classes.⁷

5. D.03-10-087, page 4.

6. D.03-10-087, page 5, Table 1.

7. D.03-10-087, page 21

PG&E ALs 2502-G, 2503-G and 2504-G,
SoCalGas AL 3318, and SDG&E AL 1541-E/1416-G/WMP*

In D.03-10-087, the Commission ordered PG&E, SoCalGas, SDG&E, Southern California Edison (SCE), and Southwest Gas (SW Gas) to file advice letters proposing tariff amendments and refund plans that implement the Commission's refund methodology. PG&E ALs 2502-G, 2503-G and 2504-G address the core aggregation, core subscription, and wholesale gas transportation customers' shares of the consideration for PG&E's core gas customers, respectively. SoCalGas AL 3318 addresses the core subscription, core procurement, and core aggregation customers' shares of the consideration for SoCalGas core gas customers. SDG&E AL 1541-E/1416-G addresses the electric, core procurement, core subscription, and core aggregation customers' shares of the consideration for SDG&E electric and core gas customers.

Four additional ALs were submitted to the Commission as follows in compliance with D.03-10-087 but are not addressed in this resolution, as the following ALs do not involve tariff revisions or refund plans for core aggregation, core subscription or wholesale gas transportation customers: 1) SCE filed AL 1759-E for its electric ratepayers (effective December 23, 2003); 2) SW Gas filed AL 700 for its natural gas customers (effective December 30, 2003)⁸; 3) PG&E filed AL 2448-E for its electric ratepayers (effective January 12, 2004); and 4) PG&E filed AL 2511-G for its core procurement customers (effective February 23, 2004).⁹ Each of these additional advice letters became effective after review by the Energy Division confirmed they were in compliance with D.03-10-087. None of these advice letters were protested.

-
8. During the time period for the Settlement, SW Gas had one core subscription and one core aggregation customer. However, since that time, SW Gas' core aggregation customer has left the system and the customers of the core aggregator are now direct customers of the Utility. SW Gas proposed in AL 700 that it would be cumbersome to calculate a net present value for prospective refunds to two former customers.
 9. PG&E submitted ALs for each specific type of customer (i.e. electric, core procurement, core aggregation, core subscription, and wholesale gas transportation) whereas SoCalGas and SDG&E submitted ALs for all applicable customers under each utility.

NOTICE

Notices for PG&E ALs 2502-G, 2503-G, and 2504-G, SoCalGas AL 3318, and SDG&E AL 1541-E/1416-G were made by publication in the Commission's Daily Calendar. Each utility states that a copy of these Advice Letters was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

PG&E's AL 2502-G was timely protested on December 18, 2003 by SPURR. SPURR argues that it is inappropriate for PG&E to employ an after-tax rate of return for the discount rate to calculate the net present value of the refund that would be provided to PG&E core aggregation customers. SPURR states that the fact that 7.8% per annum is PG&E's after-tax authorized rate of return for 2003 is not relevant. SPURR states that PG&E is merely acting as a conduit for the natural gas refund dollars. SPURR states that PG&E is not at risk for the El Paso Settlement Master Agreement, so its risk-adjusted rate of return should not be used as the discount rate in this case. SPURR states that the appropriate discount rate would reflect the net present value of the payment stream to the recipients of the refund. SPURR acknowledges that it would be administratively burdensome to attempt to determine the appropriate discount rate for each core aggregation customer entitled to receive a share of the El Paso settlement refund. Hence, SPURR recommends using an objectively-derived discount rate, unrelated to PG&E's particular financial structure, as the appropriate discount rate.

SPURR recommends that the net present value computation be based upon one of three objectively-derived rates, or an average of such rates, in effect when PG&E first receives settlement funds from El Paso:

- Wall Street Journal Prime Rate (currently about 4.0% per annum)
- Ten-Year Treasury Note Rate (currently about 4.4% per annum)
- IRS long-term Applicable Federal Rate (AFR) (currently about 5.0% per annum)

SPURR states that this would result in a fair allocation of refund proceeds as between refund recipients who will receive a lesser dollar amount up-front (core aggregation customers such as the public schools in the SPURR program) and refund recipients who will receive the full dollar amount of the refund over time

(bundled core customers). SPURR's protest concludes that the Commission should reject the PG&E Advice Filing for these reasons unless the Advice Filing is modified to be consistent with SPURR's objections.

PG&E responded to the protest of SPURR on December 29, 2003. PG&E responds that the selection criterion for the discount rate used in a net present value analysis is that the selected rate should measure the riskiness of a future stream of payments. PG&E states that the selected rate will equate the payment stream received in the future to an equivalent amount received today, adjusted for risk. PG&E states that the correct discount rate is one that would measure the level of risk associated with the long-term receipt of payments from El Paso. PG&E states that SPURR has incorrectly asserted that the appropriate discount rate would reflect the net present value of the payment stream to the recipients of the refund. PG&E states that none of the several "objectively-derived" discount rates offered by SPURR is relevant to the net present value analysis.

PG&E states that SPURR's comment that its members would receive "a lesser dollar amount upfront" than refund recipients that receive "the full dollar amount of the refund over time" shows a lack of understanding of the purpose of the net present value calculation. PG&E also refers to SPURR's support for PG&E's upfront core aggregation refund allocation mechanism in R.03-07-008¹⁰ as an indication that SPURR recognizes that the upfront payment to core aggregation customers is at least equivalent to the refund amount spread over time.

PG&E states that in accordance with the Commission's directive of taking a "minimalist approach" to reduce contention in the proceeding, PG&E selected its 7.8% after-tax authorized rate of return as the discount rate for its net present value analysis because the rate is fair to all customer groups. PG&E also stated that in selecting its discount rate, PG&E relied upon the Commission's finding in Decision 01-06-081 (regarding the disposition of the SoCalGas Montebello storage facility) that the utility's after-tax authorized rate of return is an appropriate discount rate.

10. Reply Comments of SPURR and the Association of Bay Area Governments Publicly Owned Energy Resources (ABAG) filed August 14, 2003, pages 4-5.

PG&E states that various options were reviewed in making its proposal to use its after-tax rate of return. PG&E states that a higher discount rate measuring the true financial risk of the payment stream, such as the long-term debt rate on El Paso bond issues (approximately 10-11 percent), is the more accurate discount rate to use for these funds. PG&E states that a lower rate, such as a more aggregate measure of market interest risk (approximately 4-5 percent) as proposed by SPURR will benefit core aggregation and other customers that receive an upfront allocation¹¹. PG&E states that the average of these discount rates is approximately 7.5%, which is very close to PG&E's after-tax authorized rate of return. PG&E notes that it stated in its comments to the proposed decision in R.03-07-008 that it intended to use its after-tax authorized rate of return. PG&E states this is consistent with the proposed discount rate by SoCalGas and SDG&E to calculate their customer refunds from the upfront cash allocation.

PG&E concludes that it considers its 7.8% after-tax authorized rate of return to be a fair and appropriate discount rate for the net present value analysis. PG&E states that if the Commission decides that the discount rate should be revised for core aggregation customers, PG&E requests that the same discount rate apply to wholesale and core subscription customer refund amounts as well. PG&E requests the Commission approve AL 2502-G as filed.

DISCUSSION

Although PG&E AL 2503-G and 2504-G, SoCalGas AL 3318, and SDG&E AL 1541-E/1416-G were not protested, those advice letters also provide for the use of an after-tax rate of return in calculating the net present value of the El Paso refund that will be paid to certain customer classes. In addition, we determined that there was inconsistency between the utilities in the calculation of a net present value payment stream. Therefore, we will consider those advice letters here, as well as PG&E AL 2502-G.

11. PG&E used the same discount rate to calculate the refund for core subscription and wholesale customers as filed in Advice Letters 2503-G and 2504-G, respectively.

In D.03-10-087, the Commission expressed its intent to use a “simple, direct, uniform and minimalist approach, and use existing accounting mechanisms, to the fullest extent possible”¹²

The Commission believes that PG&E’s, SoCalGas’, and SDG&E’s proposed discount rates, used to calculate the net present value of the El Paso refund owed to core aggregation, core subscription, and certain wholesale customers, generally reflect the level of risk associated with the El Paso refunds. However, we also believe that a consistent methodology, including a consistent discount rate and term, should be employed. We will deny SPURR’s protest to use a discount rate in the range of 4.0% to 5.0%.

The risk associated with the refunds is that the refunds made over a lengthy period of time will actually be made by El Paso in a manner consistent with the expectations in the El Paso Settlement. If these payments are not made in such a manner, the upfront refunds made to core aggregation, core subscription, and wholesale customers will not be consistent with the expectations of the Commission in D.03-10-087, and would affect the shares of the refund made to other core customers. The El Paso Settlement itself clearly assumes a certain level of risk in its provision that certain “deferred” refund payments may be made earlier by El Paso under certain conditions. In the Master Settlement, El Paso has the option to prepay its deferred amounts by using a discount rate of approximately 7.86% if El Paso would have been paying over a 20-year term, or a discount rate of 7.48% and a 15-year term if El Paso achieves an “investment grade” credit rating.¹³ Therefore, if El Paso does prepay the beneficiaries of the Settlement fund, these are the discount rates that will affect the prepaid amounts received by the California utilities. These discount rates are obviously quite close to the utilities’ proposed discount rates in the advice letters under consideration here.

In addition, it makes sense to adopt a discount rate and term to calculate the net present value of refunds for utility core aggregation, core subscription and

12. D.03-10-087, Attachment A-1.

13. El Paso Master Settlement, Paragraph 4.1.d(ii)(C).

wholesale customers that are not only consistent with the Settlement, but also consistent for each of the utilities. We know what discount rates and terms El Paso could use if El Paso exercises their prepayment option, and those figures would affect the amount of refunds for utility customers as a whole. We are reluctant to adopt different methodologies for each of the utilities for determining the net present value of refunds for core aggregation, core subscription, and wholesale customers. For consistency, we will adopt a single discount rate and term rather than the utilities proposed discount rates and terms.

The Commission notes that the utilities used different terms in order to calculate the net present value of the refunds. PG&E used a 15-year term, while the Sempra utilities proposed a 20-year term. No protests were made against the terms, and the choice of the terms appears to be arbitrary. After review of the El Paso Master Settlement, we stipulate that the choice of a discount rate to calculate net present value is directly related to the original length of the term of the settlement. We will adopt a 20-year payment term and a 7.86% discount rate in order to calculate the net present value of the refunds due to core aggregation, core subscription, and wholesale customers. We are choosing a 20-year term and a 7.86% discount rate (rather than a 7.48% discount rate and 15-year term) simply because El Paso has not yet achieved an “investment grade” credit rating and it would be speculative to assume if or when that would be achieved.

As for PG&E’s argument for their choice of the use of the after-tax rate of return for the discount rate, in D.01-06-081, the Commission did base a calculation of the net present value of future gas sales made by SoCalGas from its Montebello storage facility on an 8% discount rate. In that decision, the Commission ordered SoCalGas to provide an up-front credit to its customers based on an allocation of the estimated net present value of those future gas sales. It is unclear if this 8% discount rate represented SoCalGas’ after-tax rate of return. Nevertheless, the rate is quite close to the discount rate approved in this resolution and also the rates proposed by PG&E and the Sempra utilities in their advice letters under consideration here. This does not preclude the possibility of the utilities using their after-tax rate of return as discount rates for other AL proposals. In this particular circumstance, an applicable discount rate related directly to El Paso’s Settlement is known.

As for PG&E's statement in its comments on the proposed decision in R.03-07-008 that it intended "to use its after-tax authorized rate of return for 2003 of 7.8 percent as the annual discount rate", the Commission did not specifically adopt PG&E's proposal in D.03-10-087. Rather, the Commission stated "the refund plan should calculate the "up-front" payment based upon a net present value of a reasonable forecast of potential payments using a reasonable proposed discount rate."¹⁴

In all other respects, besides the appropriate discount rate and term, the Commission has reviewed the PG&E AL 2502-G, 2503-G, and 2504-G, SoCalGas AL 3318, and SDG&E AL 1541-E/1416-G, and finds that those ALs are in compliance with D.03-10-087.

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this resolution was neither waived or reduced. Accordingly, this draft resolution was mailed to parties for comments, but no comments were received.

FINDINGS

1. Commission Decision 03-10-087 directed PG&E, SCE, SoCalGas, SDG&E, and SW Gas to file an Advice Letter or Advice Letters to propose refund plans and amendments to their tariffs as needed to implement the accounting and ratemaking treatment adopted therein, concerning refunds from El Paso Settlement.

14. D.03-10-087, page 24.

PG&E ALs 2502-G, 2503-G and 2504-G,

SoCalGas AL 3318, and SDG&E AL 1541-E/1416-G/WMP*

2. Among the Advice Letters filed in response to the Commission's order, PG&E filed AL 2502-G, 2503-G, and 2504-G, SoCalGas filed AL 3318, and SDG&E filed AL 1541-E/1416-G on December 3, 2003.
3. SPURR filed a timely protest against PG&E AL 2502-G on December 18, 2003. SPURR argued that PG&E inappropriately used its after-tax rate of return as the discount rate used to calculate the net present value of refunds due to PG&E core aggregation customers.
4. PG&E responded to SPURR's protest on December 29, 2003. PG&E stated that: its after-tax rate of return was appropriate as a discount factor in view of the risks associated with the refunds; the Commission had already used an after-tax rate of return in calculating the net present value of (future gas sales) from the SoCalGas Montebello facility; and PG&E had already indicated its intent to use a 7.8% discount factor in R.03-07-008.
5. The discount rate used in El Paso's Settlement (7.86% using a 20-year payment stream) is appropriate to use as the discount factor in calculating the net present value of the El Paso refunds due to certain customer classes.
6. In the interest of consistency, the utilities should use the same discount rate and term to calculate the net present value of the refunds.

THEREFORE IT IS ORDERED THAT:

1. Pacific Gas and Electric Company Advice Letters (AL) 2502-G, 2503-G, and 2504-G, Southern California Gas Company (SoCalGas) AL 3318 and San Diego Gas & Electric Company (SDG&E) AL 1541-E/1416-G, respectively shall be modified to incorporate a discount rate of 7.86% using a 20-year payment stream for the calculation of the net present value of refunds to certain customer classes.
2. In all other respects, PG&E ALs 2502-G, 2503-G and 2504-G, SoCalGas AL 3318 and SDG&E AL 1541-E/1416-G are approved.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on April 22, 2004; the following Commissioners voting favorably thereon:

WILLIAM AHERN
Executive Director